

## Message Text

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ACTION EUR-12

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R 152310Z DEC 76  
FM AMEMBASSY OTTAWA  
TO SECSTATE WASHDC 1932

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E.O. 11652: N/A  
TAGS: EFIN, CA  
SUBJECT: FEDERAL/PROVINCIAL FISCAL ARRANGEMENTS

REF: OTTAWA 4926

1. SUMMARY: FEDERAL/PROVINCIAL FIRST MINISTERS' CONFERENCE ENDED DECEMBER 14 WITH GENERAL ACCEPTANCE BY PROVINCES OF FEDERAL PROPOSALS FOR CHANGES IN FISCAL ARRANGEMENTS BETWEEN THE TWO LEVELS OF GOVERNMENT. FEDERAL GOVERNMENT ADDED TWO MORE "TAX POINTS" TO ORIGINAL PROPOSALS TO COUNTER PROVINCIAL REQUEST FOR FOUR ADDITIONAL TAX POINTS TO COVER THEIR CLAIMED LOSS OF REVENUE RESULTING FROM CESSION OF REVENUE GUARANTEE PROGRAM, AND ALTHOUGH SOME PROVINCIAL PREMIERS TOLD PRESS THEY WERE "DISAPPOINTED" AT OUTCOME, OTHERS INDICATED THEY WERE SATISFIED. PRIME MINISTER TRUDEAU CALLED MEETING "GIANT STEP FORWARD IN DECENTRALIZING FISCAL ARRANGEMENTS IN CANADA," WHEREAS QUEBEC PREMIER LEVESQUE TERMED IT A "GYP." END SUMMARY.

2. FISCAL ARRANGEMENTS ACT, GOVERNING LARGEST SHARE OF FEDERAL TRANSFER PAYMENTS TO PROVINCES, WAS MAJOR TOPIC OF DISCUSSION DURING FEDERAL/PROVINCIAL FIRST MINISTERS' MEETING IN OTTAWA, DECEMBER 13-14. ACT, WHICH WILL EXPIRE IN MARCH 1977, HAS BEEN SUBJECT OF SEVERAL MEETINGS OF PROVINCIAL AND FEDERAL AUTHORITIES DURING 1976.

3. IN TERMS OF PAYMENTS, FISCAL ACT AND OTHER FINANCIAL ARRANGEMENTS ACTS COVER ABOUT C\$7 BILLION OF ESTIMATED C\$9 BILLION THAT GOC EXPECTS TRANSFER TO PROVINCES AND MUNICIPALITIES IN CURRENT UNCLASSIFIED

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FISCAL YEAR ENDING MARCH 31, 1977. CHIEF PROGRAMS UNDER

ACTS ARE EQUALIZATION (C\$2.2 BILLION), REVENUE GUARANTEE (C\$400 MILLION), AND SHARED-COST PROGRAMS OF POST-SECONDARY EDUCATION (C\$1.6 BILLION), MEDICARE (C\$960 MILLION) AND HOSPITAL INSURANCE (C\$2.7 BILLION). ACTS ALSO INTER ALIA COVER FEDERAL COLLECTION OF PROVINCIAL INCOME TAXES, ALLOW PROVINCES (NOW ONLY QUEBEC) TO RECEIVE TAX POINTS INSTEAD OF DIRECT PAYMENTS AND SHARE UNDISTRIBUTED 1971 INCOME OF CORPORATIONS.

4. PROGRAMS, PROPOSALS AND FEDERAL/PROVINCIAL DISAGREEMENTS:

A. EQUALIZATION - UNDER COMPLEX FORMULA SYSTEM, FEDERAL GOVERNMENT MAKES PAYMENTS TO SO-CALLED "HAVE-NOT" PROVINCES (I.E. THOSE WHOSE REVENUE BASE IS BELOW NATIONAL AVERAGE, THUS EXCLUDING ONTARIO, ALBERTA AND BRITISH COLUMBIA). FEDERAL GOVERNMENT ORIGINALLY WANTED TIE PROGRAM TO GROWTH IN NATIONAL ECONOMY BUT APPARENTLY DROPPED THIS IDEA AND PROPOSED PROVINCES COULD CHOOSE ONE OF THE THREE OPTIONS FOR RECEIVING PAYMENTS. PROGRAM WAS NOT CONTENTIOUS ISSUE, AND PROVINCES AGREED TO FEDERAL PROPOSALS.

B. REVENUE GUARANTEE - AS PART OF 1972 INCOME TAX REFORM, FEDERAL GOVERNMENT AGREED TO COMPENSATE PROVINCES FOR ANY SHORTFALL IN REVENUE BECAUSE OF FEDERAL REFORM. FEDS CLAIMED PROGRAM DESIGNED LAST ONLY FIVE YEARS AND WERE ADAMANT REGARDING CESSATION OF PROGRAM AFTER MARCH 1977. PROVINCES EQUALLY ADAMANT PROGRAM SHOULD CONTINUE IN PRESENT FORM OR, IF DROPPED, FEDERAL GOVERNMENT SHOULD ADD FOUR TAX POINTS TO "ESTABLISHED PROGRAM" FINANCING (REVISED SHARED-COST PROGRAMS). THEY CLAIMED END OF PROGRAM WOULD COST PROVINCES C\$860 MILLION, WHICH WOULD HAVE TO BE MADE UP IN NEW PROVINCIAL INCOME TAXES. FEDERAL GOVERNMENT ADDED TWO TAX POINTS TO "ESTABLISHED PROGRAM" FINANCING IN FINAL PROPOSAL AND PROMISED TO REINSTATE REVENUE GUARANTEE FOR A YEAR FOLLOWING ANY NEW FEDERAL INCOME TAX REFORM.

C. ESTABLISHED PROGRAMS - UNDER CURRENT PROGRAMS OF SHARED COST, FEDERAL GOVERNMENT PAYS 50 PERCENT OF ELIGIBLE COSTS OF POST-SECONDARY EDUCATION, MEDICARE AND HOSPITAL INSURANCE. FEDERAL GOVERNMENT CLAIMED COSTS HAS ESCALATED EXCESSIVELY AND WANTED CHANGE WAY IN WHICH FEDERAL SHARE WAS PAID. IT ALSO CLAIMED PRESENT METHOD OF PAYMENT WAS INEFFICIENT AND INTERFERRED WITH PROVINCIAL RIGHTS. THEREFORE, FEDERAL PROPOSAL WAS TO ALLOW TAX POINTS (FEDERAL GOVERNMENT WOULD LOWER ITS SHARE OF INCOME TAX BY CERTAIN PERCENTAGE AND PROVINCES WOULD RAISE THEIRS UNCLASSIFIED

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BY EQUAL AMOUNT) TO PROVINCES AND ALSO GIVE CASH GRANTS ON PER CAPITA BASIS. PROVINCES PRESUMABLY WOULD USE THIS TAX REVENUE FOR EXISTING PROGRAMS WITH MINIMUM OF FEDERAL GUIDELINES, BUT PROVINCES WOULD BE FREE TO USE REVENUE IN ANY WAY THEY CHOSE. PROVINCES GENERALLY AGREED WITH PRINCIPLE OF FEDERAL PROPOSAL BUT WANTED MORE TAX POINTS THAN FEDS PROPOSED.

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5. IN SUMMING UP RESULTS OF CONFERENCE TO PARLIAMENT ON DECEMBER 14, PRIME MINISTER TRUDEAU SAID THAT FEDERAL PROPOSALS OF 13-1/2 TAX POINTS PLUS CASH GRANTS GIVEN TO PROVINCES ON PER CAPITA BASIS FOR "ESTABLISHED PROGRAM" FINANCING WOULD RESULT IN PROVINCES RECEIVING IN FY 77/78 SOME C\$681 MILLION MORE THAN THEY WOULD GET UNDER EXISTING SHARED-COST ARRANGEMENTS. THIS FIGURE DOES NOT INCLUDE, ACCORDING TO TRUDEAU, ANOTHER C\$130 MILLION THAT COULD BE GIVEN PROVINCES UNDER EXTENDED HEALTH CARE PROPOSALS WHICH MINISTER OF HEALTH WILL DISCUSS WITH PROVINCES OVER NEXT FEW WEEKS.

6. TRUDEAU CLAIMED THAT NEW FISCAL ARRANGEMENTS, PARTICULARLY FOR "ESTABLISHED PROGRAM" FINANCING WOULD ALLOW PROVINCES GREATER FLEXIBILITY IN USE OF TAX REVENUES; PROVINCES WOULD NO LONGER SUBMIT DETAILED ACCOUNTINGS TO FEDERAL GOVERNMENT ON SHARED-COST PROGRAMS, AND BOTH PROVINCES AND FEDERAL GOVERNMENT WOULD HAVE GREATER BUDGETING PREDICTABILITY. HE TERMED CONFERENCE "GIANT STEP FORWARD IN DECENTRALIZING FISCAL ARRANGEMENTS IN CANADA" AND THAT BY TRANSFERRING 13-1/2 TAX POINTS, "THERE WILL BE A GREATER TRANSFER OF THE TAXING AUTHORITY OF THE PROVINCES."

7. ACCORDING TO PRESS REPORTS, NEWFOUNDLAND PREMIER MOORES SAID HE WAS "DISAPPOINTED" OVER RESULTS OF CONFERENCE AS DID B.C. PREMIER BENNETT. HOWEVER, NEW BRUNSWICK PREMIER HATFIELD IS QUOTED AS BEING "SATISFIED" WITH OUTCOME, AND ONTARIO PREMIER DAVIS AS CALLING CONFERENCE "SIGNIFICANT STEP FORWARD FOR FEDERAL/PROVINCIAL RELATIONS". QUEBEC PREMIER LEVESQUE WAS CHARACTERIZED BY MEDIA AS BEING ANGRY OVER CONFERENCE

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RESULTS AND CLAIMING THAT QUEBEC HAD BEEN "GYPPED" OF C\$100 MILLION.

8. COMMENT: FEDERAL GOVERNMENT DID ATTEMPT TO ACCOMMODATE PROVINCES IN THIS CONFERENCE, AND, TO LARGE EXTENT, FEDERAL PROPOSALS ON REVISED SHARED-COST PROGRAMS WERE IN KEEPING WITH LONG-STANDING PROVINCIAL DEMAND FOR MORE FLEXIBILITY IN SPENDING TAX REVENUES.

9. ALL FIGURES GIVEN BY PROVINCES AND FEDERAL OFFICIALS ARE ESTIMATES AND SUBJECT TO CONTENTION. FOR EXAMPLE, PAYMENTS UNDER THE REVENUE GUARANTEE DID NOT BEGIN UNTIL FY 74/75 AND CONTINUE TO LAG CURRENT FISCAL YEARS. THUS, FOR PROVINCES TO SAY THEY MUST RAISE TAXES IN IMMEDIATE FUTURE TO COMPENSATE FOR LOSS OF THIS PROGRAM IGNORES FACT THAT PAYMENTS WILL CONTINUE FOR SOME TIME AFTER PROGRAM CEASES IN MARCH 1977. ALSO, TRUDEAU SAID THAT PART OF TAX ALLOWANCES FOR PROVINCES WILL BE ON THREE-YEAR MOVING AVERAGE BASED ON GROSS NATIONAL EXPENDITURE. THUS, ACTUAL AMOUNTS WILL NOT BE KNOWN FOR SOME TIME. ENTIRE SYSTEM OF TRANSFER PAYMENTS TO PROVINCES IS EXTREMELY COMPLEX AND EMBASSY REFERS ANY INTERESTED READER TO OTTAWA A-341 OF JUNE 2, 1976 FOR FURTHER EXPLANATION.

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